No. 83-1996

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In the Supreme Court of the United States

OCTOBER TERM, 1984

MERCHANTS NATIONAL BANK OF MOBILE, PETITIONER

v.

FEDERAL DEPOSIT INSURANCE CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the district court properly excluded evidence outside the records of an insolvent bank pursuant to 12 U.S.C. 1823(e) in an action brought by the Federal Deposit Insurance Corporation to recover on a loan guarantee.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 10a-37a) is reported at 725 F.2d 634. The opinion and order of the district court (Pet. App. 1a-9a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on February 24, 1984. The petition for a writ of certiorari was filed on May 23, 1984. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISION INVOLVED

12 U.S.C. 1823(e) provides:

> No agreement which tends to diminish or defeat the right, title or interest of the Corporation in any asset acquired by it under this section, either as security for a

loan or by purchase, shall be valid against the Corporation unless such agreement (1) shall be in writing, (2) shall have been executed by the bank and the person or persons claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the bank, (3) shall have been approved by the board of directors of the bank or its loan committee, which approval shall be reflected in the minutes of said board or committee, and (4) shall have been, continuously, from the time of its execution, an official record of the bank.

STATEMENT

1. Respondent Federal Deposit Insurance Corporation is a federally chartered corporation that provides insurance for bank deposits pursuant to 12 U.S.C. 1811 *et seq.* In the case of a bank failure, the FDIC (in its capacity as receiver) may liquidate the assets of the bank and make direct payments to depositors from the proceeds of the liquidation and from insurance funds. Alternatively, the FDIC may use a "purchase and assumption" transaction in which it arranges for a financially sound bank to purchase some assets and assume deposit liabilities of the failed bank; the FDIC (in its corporate capacity) purchases assets that are unacceptable to the assuming bank. The FDIC is required by statute to compare the potential losses from these alternatives before choosing between them.[1] Such evaluations

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[1] 12 U.S.C. (1976 ed.) 1823(e), which was applicable at the time of the events in this case, provided that the FDIC could purchase assets of a failed bank only when "in the judgment of the Board of Directors such action will reduce the risk or avert a threatened loss to the Corporation." A similar provision now appears at 12 U.S.C. 1823(c)(4)(A), which states that the FDIC may undertake a purchase and assumption transaction only if it determines that such action is "reasonably necessary to save the cost of liquidating, including paying the insured accounts" or that continued operation of the failed bank is necessary to provide adequate banking services to the community. See Pet. App. 25a n.1.

must be performed quickly, sometimes overnight, in order to avoid interruption in banking services. Pet. App. 19a-26a.

Congress has provided the FDIC with various statutory protections in connection with transactions involving failed banks. In particular, 12 U.S.C. 1823(e) provides that in order to be valid against the FDIC agreements that tend to diminish the FDIC's rights in acquired assets must meet certain requirements, including approval by the officers of the failed bank, as reflected in minutes of the board of directors or loan committee, and status as an official record of the bank.

2. This case arose in connection with the FDIC's execution of a "purchase and assumption" transaction involving the Wilcox County Bank (WCB) of Camden, Alabama. In March 1978 WCB was declared insolvent, and the FDIC was appointed as receiver. The FDIC (in its corporate capacity) subsequently purchased certain assets of WCB, including WCB's participation in a $3.9 million loan to Ball-Co Contractors, Inc. Pet. App. 16a.

Petitioner Merchants National Bank of Mobile (MNB) was the lead bank for the loan to Ball-Co and itself took an 80% participation, which it subsequently sold to the Eastern Airlines Pension Fund. WCB's participation in the loan was in the amount of $84,000. The loan to Ball-Co was 80% guaranteed by the Farmers Home Administration (FmHA). When Ball-Co defaulted on the loan, FmHA paid 80% of the value of the loan to the Eastern Airlines Pension Fund at the Fund's request. WCB did not receive any part of the guarantee payment from FmHA; nor did it receive any of the proceeds from petitioner's sale of its loan participation to the Eastern Airlines Pension Fund. Pet. App. 15a-17a.

3. The FDIC sued petitioner in the United States District Court for the Southern District of Alabama to recover WCB's pro rata share of the FmHA loan guarantee.

Petitioner contended that the FDIC was not entitled to any part of the guarantee because WCB's participation allegedly was confined to the 20% of the Ball-Co loan that had not been guaranteed. Pet. App. 17a-18a.

Following a bench trial, the district court entered judgment in favor of the FDIC (Pet. App. 1a-9a). The court found that WCB's participation was in the Ball-Co loan as a whole and that the FDIC therefore was entitled to receive a pro rata share of the 80% FmHA loan guarantee. The court noted that WCB's records showed that its participation was 80% guaranteed by FmHA and that under 12 U.S.C. 1823(e) the FDIC was entitled to rely on the terms of the loan participation as they were set out in WCB records.

4. The court of appeals affirmed (Pet. App. 10a-37a). It agreed with the district court that under 12 U.S.C. 1823(e) the FDIC was entitled to rely on WCB records to establish WCB's participation in the guaranteed portion of the Ball-Co loan (Pet. App. 31a). The court of appeals concluded that petitioner's attempt to rely on evidence outside WCB records to show that WCB had participated only in the unguaranteed portion of the loan was inconsistent with Section 1823(e). The court of appeals affirmed the district court's findings that the WCB records reflected participation in the guaranteed loan and that the FDIC was entitled to share ratably in petitioner's collection on the loan (Pet. App. 33a). The court of appeals also held that knowledge by FDIC employees about any collateral arrangement relating to the WCB participation would be irrelevant to the FDIC's right to enforce the loan participation as it appeared in WCB's records (*id.* at 34a-36a).[2]

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[2]Petitioner had alleged that certain FDIC employees had learned that WCB's participation in the Ball-Co loan was unguaranteed in the course of negotiating a cease and desist order with WCB.

ARGUMENT

1. Petitioner contends (Pet. 12-15, 17-19) that the district court erred in excluding evidence outside WCB records in determining whether WCB's participation in the Ball-Co loan was guaranteed by FmHA. That contention is without merit.

Congress has provided expressly in 12 U.S.C. 1823(e) that any agreement that tends to diminish the FDIC's interest in assets acquired from a failed bank shall not be valid against the FDIC unless, inter alia, it was approved by the officers of the failed bank, as reflected in the minutes of the board of directors or loan committee, and constitutes an official record of the bank. As the court of appeals explained (Pet. App. 26a-27a), Section 1823(e) facilitates the FDIC's ability to consummate a "purchase and assumption" transaction by enabling it to rely on the books and records of a failed bank in deciding whether to undertake such a transaction. See also, *e.g.*, *FDIC* v. *Hoover-Morris Enterprises*, 642 F.2d 785, 787 (5th Cir. 1981) (citation omitted) (protection of Section 1823(e) allows the FDIC to "rely upon the records of the bank in purchasing assets"). The protection afforded by Section 1823(e) is essential to the FDIC's ability to act quickly in rescuing failed banks. See *Gunter* v. *Hutcheson*, 674 F.2d 862, 865-866 (11th Cir.), cert. denied, 459 U.S. 826 (1982).

In this case Section 1823(e) allowed the FDIC to look solely to WCB's records in order to identify the bank's assets at the time it failed. The WCB records indicated that WCB's participation in the Ball-Co loan was guaranteed by FmHA. As the courts below noted (Pet. App. 4a-5a, 14a-15a), the minutes of the WCB loan committee refer twice to WCB's participation in a loan "which has an 80% [FmHA] guarantee." In addition, the MNB/Ball-Co loan agreement, which petitioner itself delivered to WCB with the certificate of participation, indicates that the underlying loan was

protected by an FmHA guarantee, while the certificate gave WCB the right to share in all collateral and security for the loan (*id.* at 32a). Nothing in WCB's records (including the documents supplied to WCB by petitioner) stated that the WCB loan participation was not guaranteed by the FmHA (*id.* at 5a-6a, 8a).

Petitioner nevertheless contends that it should have been permitted to introduce evidence outside the WCB records to show that the WCB participation was not guaranteed. According to petitioner, 12 U.S.C. 1823(e) applies only when there is an attempt to prove the existence of a collateral agreement and does not preclude introduction of evidence that would help to define the asset itself.

The court of appeals correctly recognized that the distinction petitioner urges is not a meaningful one.[3] Many agreements or understandings that do not appear in a failed bank's records might be characterized as necessary to define the true nature of an asset the bank holds. If petitioner's contention were accepted, evidence outside the records of a failed bank could be introduced against the FDIC in many cases on the ground that it was relevant to definition of an asset, rather than to existence of an agreement that would modify the asset. As the court of appeals noted (Pet. App. 31a), "MNB's construction would drain substantial vitality from Sec. 1823(e), as applied to this case, by throwing into question the very records of the bank that the statute entitles FDIC to consider and rely upon." If petitioner's semantic distinction were to prevail, the result would be that at the time the FDIC was considering a purchase and assumption transaction, it could not be sure the assets that appeared on the face of the bank's records would not later be defined

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[3]See also *Black* v. *FDIC*, 640 F.2d 699, 701 (5th Cir.), cert. denied, 454 U.S. 838 (1981) (applying Section 1823(e) to preclude attempts to "engraft" unwritten understandings onto an agreement).

away by evidence from outside those records. See Pet. App. 29a. That result would be clearly inconsistent with Congress's intent to afford special protection to the FDIC in connection with its failed bank transactions. See page 5, *supra*.

Petitioner contends (Pet. 17-18) that the decision below conflicts with *Howell* v. *Continental Credit Corp.*, 655 F.2d 743 (7th Cir. 1981), and *Gunter* v. *Hutcheson, supra*. In fact, there is no such conflict. In *Howell* the court held that when the document the FDIC sought to enforce on its face manifested the terms on which the defendant relied, Section 1823(e) did not preclude the introduction of evidence relating to those terms. In that case the defense was "flagged on the face of the instrument" that appeared in the books of the failed bank, so that "the *foundation* and *basis* of that defense [was] in a document arguably meeting the nonsecrecy requirements of § 1823(e)." 655 F.2d at 747-748 (emphasis in original). *Howell* thus presented a very different situation from this case, in which the WCB records do not include any support for petitioner's claim that the WCB participation was not guaranteed.

The Eleventh Circuit's decision in *Gunter* v. *Hutcheson, supra*, is likewise distinguishable. In *Gunter* the court held that Section 1823(e) would not operate to bar claims that an asset of a failed bank was invalid for fraud.[4] The court of appeals here expressly concluded (Pet. App. 30a) that the present case does not fall within the "narrow exception[ ]" to Section 1823(e) established by *Gunter*, since there is no claim that the WCB loan participation was invalid. Moreover, in *Gunter* the court concluded that certain alleged

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[4]The court in *Gunter* did conclude, however, that the state and common law fraud claims in that case were barred by a federal rule of common law that protected the FDIC. See 674 F.2d at 868-874.

misrepresentations could not be characterized as "agreements" and thus did not fit within the language of Section 1823(e). Here petitioner is clearly attempting to prove an agreement concerning the loan participation. In any event, even if there were a conflict between decisions of the Eleventh Circuit on this point, it would not warrant this Court's attention. See *Wisniewski* v. *United States*, 353 U.S. 901 (1957).

2. Petitioner also contends (Pet. 15-17) that the court of appeals erred in concluding that any knowledge FDIC employees may have had concerning whether the WCB loan participation was guaranteed by the FmHA would not constitute a basis for estopping the FDIC from enforcing the loan participation as it appeared in WCB records. That contention, too, lacks merit.

In Section 1823(e) Congress defined the characteristics a collateral agreement must possess in order to be valid against the FDIC. There is no suggestion in that provision that the statutory requirements may be circumvented when it is alleged that some FDIC employees had actual knowledge concerning terms of an agreement. See *FDIC* v. *de Jesus Velez*, 678 F.2d 371, 375 (1st Cir. 1982) (knowledge by the FDIC and constructive knowledge of bank directors are not relevant under Section 1823(e)). Moreover, as the court of appeals noted (Pet. App. 35a-36a), there are sound policy reasons for not reading into the statute a provision holding the FDIC liable for any knowledge possessed by its employees concerning side agreements or the hidden meaning of bank assets. Examiners from the open-bank division of the FDIC visit failing banks frequently. If knowledge obtained by these open-bank examiners could bind the FDIC's closed-bank division, "the protection of Sec. 1823(e) would be lost" (Pet. App. 36a), with the result that the FDIC could no longer value assets of a failed bank quickly and accurately.

Petitioner contends that it should be able to circumvent the terms of the statute by invoking principles of equitable estoppel. But as this Court has recently noted, "it is well settled that the Government may not be estopped on the same terms as any other litigant." *Heckler* v. *Community Health Services,* No. 83-56 (May 21, 1984), slip op. 8. In view of "the public interest in ensuring that the Government can enforce the law" (*ibid.*), there is a heavy burden on any private party that urges an exception to the general rule that the government may not be estopped (*id.* at 9). The circumstances of this case do not present any compelling reason for such an exception, particularly since petitioner itself could have ensured that all relevant terms of the WCB participation were expressed in the documents it forwarded to WCB. See Pet. App. 30a-31a, 32a.

Moreover, *Community Health Services* makes clear that, at a minimum, a private party seeking to estop the government must demonstrate with clarity that "the traditional elements of an estoppel are present" (slip op. 9). Those elements include justifiable detrimental reliance on materially misleading representations or conduct by the party sought to be estopped (slip op. 7). Since Section 1823(e) clearly defines the circumstances in which terms of an agreement will be valid against the FDIC, any belief by petitioner that the FDIC would deviate from the statutory requirements in this case would have been unreasonable.[5]

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[5]Furthermore, the record would not support a conclusion that petitioner ever acted in reliance on any statement or conduct by the FDIC. Petitioner asserts (Pet. 15-16 & n. 11) that it would not have become the lead bank for the Ball-Co loan if a Deputy Director of the FDIC had not advised petitioner orally that it would be permissible for WCB to participate in the unguaranteed portion of the loan. Petitioner does not cite any record support for this allegation, and its written offer of proof, in the form of proposed findings of fact (see Exhibit B to petitioner's opening brief in the court of appeals), makes no mention of such a conversation or of any reliance by petitioner on other statements or

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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JULY 1984

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conduct by the FDIC at the time of the loan. Petitioner's oral offer of proof regarding testimony of an MNB officer does not state that the FDIC gave any sort of formal "approval" to actions of petitioner or WCB; nor does it state that petitioner would have refrained from acting as lead bank if the FDIC's alleged conduct had been different. See Sept. 21, 1982 Tr. 79-80. And see *Community Health Services*, slip op. 13 (suggesting that receipt of oral advice from government agents could not form the basis for estoppel of the government).